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No. 81-2394

IN THE

Supreme Court of the United States

October Term, 1981

WESTINGHOUSE ELECTRIC CORPORATION,
Appellant,

against

JAMES H. TULLY, JR., *et al.*, As The Tax Commission of the State of New York,
Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK

MOTION TO DISMISS OR AFFIRM

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Questions Presented.

1. Whether the provisions of the New York State Tax Law which limits eligibility for an export tax credit against taxes measured by the New York income of a domestic international sales corporation (DISC) from the sale of export property shipped from a regular place of business in New York State, violate the Commerce Clause of the United States Constitution and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution?

2. Does the New York Tax Law which imposes a tax on the consolidated income of a corporation and its wholly owned DISC subsidiary allocable to New York, violate the Commerce Clause of the United States Constitution and the Due Process Clause and Equal Protection Clauses of the Fourteenth Amendment to the United States Constitution, where no showing has been made that the tax is being imposed on income of affiliates of a parent which are not doing business in New York State?*

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*Westinghouse Electric Corporation was the respondent-appellant in the New York Court of Appeals. James H. Tully, Jr., Milton Koerner and Thomas H. Lynch, as the Tax Commission of the State of New York, were the appellants-respondents.

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SUPREME COURT OF THE UNITED STATES,

OCTOBER TERM, 1981.

WESTINGHOUSE ELECTRIC CORPORATION,

Appellant,

against

JAMES H. TULLY, Jr., *et al.*, As The Tax Commission of The State of New York,

Appellees.

ON APPEAL FROM THE COURT OF APPEALS OF THE STATE OF NEW YORK.

Motion to Dismiss or Affirm.

The appellees move the Court to dismiss the appeal on the ground that it is manifestly evident that this case presents no substantial Federal question. This appeal is from an order of the Court of Appeals of the State of New York, entered on April 1, 1982, which unanimously modified, and as so modified, affirmed an order of the Appellate Division, Third Department, of the Supreme

Court of the State of New York, in accordance with the opinion (Judge Fuchsberg) of the New York State Court of Appeals.

The opinion of the New York Court of Appeals, dated April 1, 1982, is reported at 55 N.Y. 2d 364 and 449 N.Y.S. 2d 677, and is reprinted in the appellant's Appendix ("App.") to its Jurisdiction Statement at pages 1a-10a. The unpublished Order of the New York Appellate Division, Third Judicial Department, dated June 29, 1981, appears at App. 11a-12a. The decision of the Appellate Division, Third Judicial Department, dated June 18, 1981, is reported at 82 A.D. 2d 988 and 440 N.Y.S. 2d 397, and is reprinted at App. 13a-17a. The unpublished order of the Supreme Court of the State of New York transferring the proceedings to the Appellate Division, dated January 25, 1980, appears at App. 18a-19a. The unpublished decision of the New York State Tax Commission, dated August 31, 1979, appears at App. 20a-26a.

Relief Requested.

This Court should dismiss the appeal on the ground that it does not present a substantial Federal question. Alternatively, this Court should affirm for the reasons expressed by the New York State Court of Appeals below.

Statutory Operation.

Under the Internal Revenue Code (Public Law 92-178) for taxable years beginning after 1971, a domestic sales corporation whose income is predominantly (95%) derived from export sales and rentals may defer paying United States tax up to 50% of that income. The other

half is taxed directly to shareholders even though it is not distributed to the shareholders, but under the law is "deemed" distributed to them. Such distributions are deemed part of such shareholders' Federal taxable income. A corporation entitled to this treatment is referred to as a "Domestic International Sales Corporation" (DISC). The tax-deferred income is never taxed to the DISC. Such income is taxed to the shareholders only when distributed, when a shareholder sells his stock, or when the corporation no longer qualified as a DISC. The 50% of the DISC's income that is taxed directly to shareholders, certain other constructive distributions, and actual distributions to shareholders are treated as dividends (but, in the case of actual distributions, only to the extent that they exceed income previously taxed directly to shareholders). The shareholders are entitled to claim an Internal Revenue Code, § 902, "deemed" foreign tax credit for taxes paid by a DISC to foreign countries. A DISC may not join in filing a Federal consolidated return. Under the intercompany pricing rules of the Federal law, a DISC may earn profits although in excess of profit it would earn in an arm's length transaction and regardless of the sales price actually charged on products which it purchases from a related company and then resells for export.

Public Law 92-178 enacted December 10, 1971 was designed to provide Federal "tax incentives for United States firms to increase their exports". H.R. No. 92-533, 92nd Congress, 1st Sess. (1971), U.S. Code Cong. & Admin. News, p 1825 at 1872; Senate Report 92-437, *id.*, p 1918 at 1928. It was not designed to regulate commerce. "As a general rule, the bill provides that a DISC is not to be subject to income taxes (or more specifically the taxes imposed by subtitle A) [Income Taxes imposed by Internal Revenue Code] although the shareholders are taxed on an

amount representing up to 75 percent of a DISC's base period income." *U.S. Code Cong. & Admin. News*, Vol 2, at p 1873 (1971).

On September 8, 1971, shortly before the DISC legislation was enacted, John S. Nolan, Deputy Assistant Secretary of the Treasury for Tax Policy, spokesman for the sponsoring department, in the company of then Secretary of Treasury John B. Connally, officially appeared at a hearing before the Committee on Ways and Means of the House of Representatives. There, Mr. Nolan, in response to an expression of committee concern that the proposal might "prohibit States from levying corporate income taxes on a DISC" was unequivocal in his declaration that the proposed bill would leave the States "free to impose the tax, if they choose to do so" (*see* Hearings before House Committee on Ways and Means on the Tax Proposals Contained in the President's New Economic Policy, 92nd Cong., 1st Sess., Part I, pp. 170-171). Proposed legislation which might have preempted the States from taxing DISCs was considered by the same committee in 1980, only to be permitted to die without any action (*see* HR 5076, 96th Cong., 2nd Sess.; Hearing before Committee on Ways and Means on State Taxation of Foreign Source Income, p. 29, 326).

A DISC is not taxed by New York State. When a corporate taxpayer subject to franchise tax for the exercise of the privilege of doing business in New York State under Article 9-A of the Tax Law is a shareholder of an exempt DISC, the corporate taxpayer must file its own tax report and a consolidated report with the DISC. The consolidated report must contain the attributable share (based on percentage of stock ownership) of the receipts, expenses, assets and liabilities of the DISC as well as the property,

receipts and wages of the DISC eligible for use in the computation of the business allocation percentage. The corporate taxpayer must adjust its receipts, expenses, assets and liabilities to include its attributable share of the DISC's receipts, expenses, assets and liabilities; eliminate any deemed or actual distributions received from the DISC to the extent already included in entire net income; and eliminate intercorporate transactions between the corporate taxpayer and the tax exempt DISC (McKinney's New York Tax Law, §§ 208[9] [i], 210 [3] [a]). As an alternate to filing a consolidated return with a DISC, a corporate taxpayer may elect to file a tax report on a combined basis with a DISC because of intercompany transactions in order to properly reflect its tax liability (McKinney's New York Tax Law, § 211[4]).

Further, New York State allows a stockholder of exempt DISCs a DISC export credit, computed separately for each DISC, after allowance of any credit for an eligible business facility and the credit for investment in production facilities. The credit is computed as follows:

(1) Stockholder's share of DISC earnings and profits X (Gross receipts from export property shipped from a regular place of business within the State / Gross receipts from the sale, rental or other disposition of export property) X Taxpayer's business allocation percentage = Taxable income eligible for the credit

(2) Taxable income eligible for credit X 70% X Taxpayer's rate of tax = Credit attributable to each DISC

(McKinney's New York Tax Law, § 210 [13] [a])

Under the New York Tax Law income, gains and losses from subsidiary capital are excluded in computing entire net income. In place of a tax on subsidiary income, a separate tax measured by subsidiary capital* is imposed as part of the New York corporation franchise tax unless a combined report is filed by the subsidiary with its parent. The separate tax on subsidiary capital is in addition to the tax measured by entire net income, other alternative basis or the flat minimum tax.

A "subsidiary" not a DISC is defined to mean a corporation which is controlled by the taxpayer by reason of its actual beneficial ownership of 50% of the issued and outstanding stock entitled to vote for the election of directors or trustees of the corporation. No tax is imposed on subsidiary capital where the subsidiary does not do business in New York.

Factual Statement.

Westinghouse Electric Corporation (Westinghouse) is engaged in the manufacture, sale and installation of electrical and steam apparatus and does business in New York. Westinghouse owns all of the stock of Westinghouse Electric Export Corporation (Westinghouse DISC), a Delaware corporation which elected to be treated as a "domestic international sales corporation" for Federal income tax purposes and was so treated for the years involved.

*Subsidiary capital includes (1) investments in stocks of subsidiaries, and (2) the amount of indebtedness owed to a taxpayer by its subsidiaries, exclusive of accounts receivable acquired in the ordinary course of trade or business for services rendered or for sales of property held primarily for sale to customers, on which no interest was claimed and deducted for the purpose of any New York franchise tax imposed by Articles 9-A, 9-B, 9-C, 32 or 33 of the New York Tax Law.

Westinghouse DISC had no paid employees, did not engage in business activities in New York State, did not employ capital, own or lease real or tangible personal property, pay real estate rentals, or maintain an office in New York State at any time during the years involved. It did not file New York corporate franchise tax returns.

Westinghouse DISC received all of its business income for the years involved acting as a commission agent for Westinghouse and affiliated companies in respect to export sales of property and related services. Westinghouse DISC reported total income on Federal Form 1120-DISC as follows:

Sources of Income	*1972*	*1973*
From Westinghouse	$19,888,000	$47,180,132
From affiliated companies of Westinghouse	6,099,000	10,768,606
TOTALS	$25,987,000	$57,948,738

The affiliated companies did not do business in New York State.

Under the provisions of section 995(b) of the Internal Revenue Code, $12,956,500 for 1972 and $29,838,006 for 1973 was deemed distributed to Westinghouse during those years. Westinghouse accordingly included those amounts in its Federal gross income for those years. Federal taxation of the remainder of Westinghouse DISC's income for those years was deferred under the provisions of the Internal Revenue Code.

Westinghouse DISC made no distribution of income in 1972, but in 1973 it distributed $10,068,500 to Westinghouse. For Federal purposes this distribution was treated

as made out of previously taxed income under section 996(a) (1) of the Internal Revenue Code.

Westinghouse filed New York State corporation franchise tax returns for these years in which it reported entire net income of $136,516,711 for 1972 and $43,715,850 for 1973. These amounts included the $12,956,500 and $29,838,006 deemed distribution of income from Westinghouse DISC for those respective years. The reported income did not include any portion of Westinghouse DISC's accumulated income which was deferred for tax purposes under Federal law.

On the New York State returns, Westinghouse's reported entire net income was allocated to New York State under "business allocation percentages of 6.387743% for 1972 and 6.239516% for 1973 computed without regard to such deemed distributions" by Westinghouse DISC. Westinghouse paid New York State franchise taxes in the amount of $749,384 for 1972 and $205,548 for 1973.

After an audit of Westinghouse, notices of deficiency were issued for the years in the amount of $73,970.23 plus interest for 1972 and $151,436.76 plus interest for 1973. An error was made in the calculation of the deficiency for 1972 because of a transposition of a number. The deficiency of tax, if the error had not been made, should be $71,970 for that year.

The notices of deficiency of tax were computed by the New York State Tax Commission on the following basis:

(a) Because more than 5% of Westinghouse DISC's gross receipts in both 1972 and 1973 consisted of sales

commissions from Westinghouse, Westinghouse DISC is exempt from New York State franchise tax under § 208.9(i) (A) of the New York Tax Law, whether or not New York State otherwise had jurisdiction to subject it to tax. Westinghouse is required under section 208.9(i) (B) of the New York Tax Law to consolidate Westinghouse DISC's receipts, expenses, assets and liabilities with its own in computing its New York State income tax liability, excluding all transactions between Westinghouse and Westinghouse DISC. Since Westinghouse included only the deemed distributions from Westinghouse DISC for 1972 and 1973, and not all Westinghouse DISC's income for such years in its own entire net income for 1972 and 1973, Westinghouse's entire net income for 1972 was increased by $13,390,500 (correct amount should be $13,030,500) from $136,516,711 to $149,907,211 and its entire net income for 1973 was increased by $28,110,732 from $43,715,850 to $71,826,582;

(b) The receipts factors used to compute Westinghouse's business allocation percentages for 1972 and 1973 were recomputed by adding Westinghouse DISC's commission income derived for such years from customers other than Westinghouse (which other customers did not do business in New York State and were not subject to New York tax) to the denominator of such factors, but not to the numerator, thus reducing Westinghouse's receipts factor for 1972 from 5.945712% as reported on its 1972 return to 5.935845% and reducing its receipts factor for 1973 from 5.665182%, as reported on its 1973 return, to 5.650114%. Such a calculation results in a reduction of Westinghouse's business allocation percentage for 1972 from 6.387743% to 6.384454% and for 1973 from 6.239516% to 6.234494%. The net effect of the two adjustments for 1972 described above increased Westinghouse's business income for 1972 allocable to New

York State from $8,683,334 to $9,533,778, an increase of $850,444, with a resulting deficiency in tax for 1972 of $76,539.96. Similarly, the net effect of the adjustments for 1973 described above increased Westinghouse's business income for 1973 allocable to New York State from $2,702,912 to $4,453,304, an increase of $1,750,392, with a resulting deficiency in tax for 1973 of $157,535.28;

(c) Westinghouse was allowed credits under section 210(13) (a) of the Tax Law in the respective amounts of $2,569.77 and $6,098.22 for 1972 and 1973. Such credits were computed by first multiplying $13,390,500 and $28,110,732, representing accumulated Westinghouse DISC income for 1972 and 1973 respectively, as computed by the auditor, by 4.771297% and 5.523182%, respectively. Those percentages are the percentages of Westinghouse's receipts from export property on which Westinghouse DISC earned a sales commission and which were shipped from a regular place of business of Westinghouse in New York as compared to Westinghouse's total receipts on the sale of export property for such years for which Westinghouse DISC received a sales commission. Such total receipts amounted to $223,587,000 in 1972 and $408,080,000 in 1973.

The respective products, $638,091 for 1972 and $1,552,607 for 1973, were then multiplied by Westinghouse's revised business allocation percentages for the respective years, with the result that of the $13,390,500 and $28,110,732 includable in Westinghouse's entire net income for 1972 and 1973, respectively, only $40,790 and $96,797 respectively, were found to be eligible for credit under section 210(13) (a). These amounts were then multiplied first by 70% and then by the 9% rate of tax in effect for 1972 and 1973 to arrive at credits of $2,569.77 and $6,098.22 for 1972 and 1973, respectively.

Proceedings Below.

Westinghouse filed a petition for a redetermination of the notices of deficiency issued for 1972 and 1973. In the petition it contended that by requiring Westinghouse to compute its franchise tax liability by combining its receipts and expenses with those of Westinghouse DISC, thereby taxing accumulated DISC income and deemed distributed income of Westinghouse DISC appellees violated the Commerce Clause of the United States Constitution and the Due Process and Equal Protection Clauses of the Fourteenth Amendment. Westinghouse also contended that limiting the export credit to income attributable to shipments made from a regular place of business in New York State violated the Commerce Clause and the Equal Protection Clause. The State Tax Commission's determination denied Westinghouse's petition (App, 26a).

Westinghouse brought a proceeding in the New York Supreme Court for judicial review of the State Tax Commission's determination in which it again raised its constitutional claims. The proceeding was transferred to the Appellate Division, Third Department, for disposition (App, 18a-19a).

The Appellate Division, two Justices dissenting, held that New York Tax Law, § 208 (subd 9, par [i], subpar [B]), to the extent it requires Westinghouse DISC's accumulated income be added to Westinghouse's income, is unconstitutional on the ground that it settles an impermissible burden on foreign commerce (App, 13a-17a).

The State Tax Commission appealed from that portion of the Appellate Division's decision that invalidated section 208.9(i) (B), and Westinghouse cross-appealed to the

extent that the Appellate Division had upheld the tax on deemed distributions. Westinghouse raised the constitutional claims that it had presented before the State Tax Commission and the Appellate Division, and which it claims before this Court. The Court of Appeals rejected Westinghouse's constitutional claims and upheld the franchise tax in all respects (App, 1a-10a). Its order modified the order of the Appellate Division and reinstated the determination of the State Tax Commission (App, 10a, 27a).

ARGUMENT.

POINT I.

The New York Tax Law which imposes a tax on the consolidated income of a corporation and its wholly owned DISC subsidiary allocable to New York does not violate the commerce clause of the United States Constitution and the due process and equal protection clauses of the Fourteenth Amendment to the United States Constitution, where no showing has been made that the tax is being imposed on income of affiliates of a parent which are not doing business in New York State.

Westinghouse and Westinghouse DISC operate a unitary business. Only Westinghouse DISC's income, accumulated and deemed distributed that was allocable to New York State under its three factor allocation formula was subjected to New York taxes. Westinghouse does not attack the allocation formula nor as found by the New York Court of Appeals does the record show that Westinghouse DISC's income was improperly apportioned to business done in New York State. The record does show that the income of Westinghouse DISC was related to the

activities of Westinghouse in New York State. The record does not show that any income of Westinghouse's affiliates which do not do business in New York State was subjected to New York taxes. New York State's allocation formula excludes the income of such affiliates.

The receipts factor used by the Commission to compute Westinghouse's allocation percentage is determined by adding Westinghouse DISC's commission income derived from customers other than Westinghouse (which other customers were not subject to New York tax) to the denominator of such factors, but not to the numerator reduced Westinghouse's receipts factor. Such a calculation resulted in a reduction of Westinghouse's business allocated percentage. The calculation is designed to eliminate income of affiliates which do not do business in New York and are thus excluded from New York tax.

Recently in *Mobil Oil Corporation v. Commissioner of Taxes,* 445 U. S. 425 (1980), it was held that a state may tax apportioned dividend income of a taxpayer received from subsidiaries and affiliates operating abroad. This Court pointed out that the linchpin of apportionability for state income taxation is the unitary business principle. Apportioned profits earned by a division of a functionally integrated division of a unitary business are subject to state taxation. A state may ignore the division. between parent and subsidiary in determining the scope of a unitary business that may be subject to the state's apportioned tax on net income. Such taxation violates neither the Due Process nor the Commerce Clause of the United States Constitution (see also, *Asarco v. Idaho State Tax Comm.,*____U. S.____, 42 CCH S. Ct., Bull. p B4378 [June 29, 1982]; *F. W. Woolworth v. Taxation & Rev. Dept,*____US____, 42 CCH S. Ct., Bull. p B 4428 [June 29, 1982]).

As a matter of general principle it would seem to make little difference for purposes of state taxation whether an interstate or international unitary business is conducted by a single corporation or by a group of corporations under common ownership and control. Early cases of this Court involved corporations which were engaged in manufacturing a product in one state and selling it in others. (See, *Underwood Typewriter v. Chamberlain*, 254 U. S. 113 [1920]; *Bass, Ratliff & Gretton v. State Tax Commission*, 266 U. S. 271 [1924].) This Court concluded that it was not feasible to determine separately the profits realized in each state. Separate accounting would require the setting of prices for the transfer of the products from the manufacturing division of the business to the marketing division. Any such price would necessarily be artificial and arbitrary. The same can be said for the prices at which a manufacturing corporation sells to its wholly-owned sales subsidiaries. Under the provisions of Internal Revenue Code, §994, the pricing rules permit a DISC to make profits in excess of those which it would earn in an arm's length transaction. In such circumstances, it is proper to require that the income of the affiliated corporations be combined for purposes of apportionment. (See Keesling & Warren, *California's Uniform Division of Income for Tax Purposes Act*, 15 UCLA Intra L Rev 156 [1967]; Hellerstein, *Recent Developments in State Tax Apportionment and the Circumscription of Unitary Business*, 21 Nat'l Tax J. 487 [1968].)

As an alternate to filing a consolidated return with a DISC, a corporate taxpayer may elect to file a tax report on a combined basis with a DISC (Tax Law, §211[4]). The petitioner did not elect to file a combined report with Westinghouse DISC. If it had made the election, it would

have been taxed like other corporations. Because of intercompany transactions, if Westinghouse DISC had not elected to be taxed as a DISC, it could have been required to file a combined report with petitioner. In *Matter of Wurlitzer Company v. State Tax Commission,* 35 N. Y. 2d 100 (1974), where a foreign corporation doing business had formed a subsidiary corporation not doing business in New York to provide financing of the parent corporation, the Court held that a combined report is an accurate reflection of income subject to New York taxation. Westinghouse in the proceedings below has never shown what its tax liability would have been had Westinghouse DISC not elected to be taxed as a DISC. Accordingly, the New York tax does not violate the Due Process Clause of the Constitution. The New York tax does not conflict with the Federal regulation of foreign commerce.

Congress has the right to regulate foreign commerce. As we discussed in the statutory operation (*supra*), the history of the Federal DISC legislation demonstrates that Congress has regulated foreign commerce conducted by a DISC with regard to taxation. To promote foreign trade some Federal Tax on the income of a DISC has been deferred. However, Congress in doing so permitted the states to tax DISC income if they chose to do so. Thus, whether or not a DISC is deemed to be an instrumentality of foreign commerce, it appears that such a new holding would be irrelevant to this case. Further, no showing has been made that a DISC's income allocable to New York State is or can be subjected to international multiple taxation. For that matter there is no showing that New York allocable income of a DISC is subjected to multiple state taxation. It follows then that *McGoldrick v. Gulf Oil Corp.,* 309 U. S. 414 (1940), and *Japan Lines, Ltd. v. County of Los Angeles,* 441 U. S. 439 (1979), cited by Westinghouse in

support of its claim that the New York tax violates the Commerce Clause of the United States Constitution are inapposite. The New York tax does not interfere with foreign commerce in any manner which conflicts with the Federal government's regulation of foreign commerce but is in harmony with it.

POINT II.

The provisions of the New York State Tax Law which limit eligibility for an Export Tax Credit against taxes measured by the New York income of a DISC from the sale of export property shipped from a regular place of business in New York State do not violate the Commerce Clause of the United States Consitution and the Equal Protection Clause of the Fourteenth Amendment to the United States Constitution.

States are free to use their taxing power "to encourage the growth and development of intrastate and industry • • • [and to] compete with other states for a share of interstate commerce; such competition lies at the heart of a free trade policy." *Boston Stock Exchange v. State Tax Comm.*, 429 US 318, 336-337 (1977). Thus a state can impose a small tax or no tax on a business activity conducted within its borders to promote such activity even though the tax policy results in a business activity moving from a sister state which taxes such activity heavier.

As discussed above, New York has the right to tax Westinghouse on the New York allocated income of Westinghouse DISC. New York Tax Law §210.13(a) allows Westinghouse an export tax credit based upon the gross receipts attributable to export property shipped from the regular place of business of the taxpayer within New York.

Neither the statute nor the record demonstrates that New York is giving an impermissible commercial advantage to business done within New York at the expense of out-of-state business or activities by giving an export credit.

A tax credit cannot be applied to taxes when no taxes are imposed. The tax credit given by New York is applied to New York allocated income of Westinghouse DISC. The income of Westinghouse DISC attributable to affiliates of Westinghouse which do not do business in New York is not subject to New York taxes and is not taxed.

The record does not show that Westinghouse's New York taxes would be less if it and its affiliates increased their exports from a regular place of business of the taxpayer in New York. Since the credit only applies to exports from a regular place of business of the taxpayer in New York, an increase in Westinghouse's and its affiliates' exports from New York should result in a higher amount of its New York taxes based on the increase of New York activities and profits. In such an event the numerator of the factors used to determine the allocation percentage would be increased since its New York payroll, property and receipts would be required to be increased to facilitate shipments from New York. At the same time the denominator of the factors would decrease thus raising the New York allocation percentage. The credit merely decreases the amount of taxes which New York could impose without discriminating against a company which exports property from a place of its business without New York.

If New York is creating a tax haven, companies would be enticed to export property from New York. There is no showing that the petitioner and its affiliates or that any other company is exporting property from New York in order to take advantage of New York's export tax credit.

From all the foregoing, we submit that there is no substantial Federal question presented by this appeal.

CONCLUSION.

The appeal should be dismissed or, in the alternative, the order affirmed.

Dated: Albany, New York
July 19, 1982

Respectfully submitted,

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